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TREASURY FOR AMB HOLMER/WRIGHT/TSMITH
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USDOC FOR ITA DAS KASOFF, MELCHER, MAC/OCEA
NSC FOR WILDER/LOI
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SUBJECT: (SBU) NANJING BANKERS NOTE SURGE IN GOVERNMENT PROJECT LOANS

¶11. (SBU) Summary. Chinese domestic and Hong Kong commercial bank representatives in Nanjing confirmed that new lending for government-sponsored projects surged in December and January. Over the past year, said the officials, lending quotas established by China's central bank have made the greatest difference in loan issuance rates. Provincial governments, however, set lending priorities; both the Jiangsu Governor and the Jiangsu vice governor in charge of financial affairs pressured banks to fall in line at an October meeting. Nonetheless, some Nanjing banks are finding it difficult to fulfill instructions to lend to small and medium-size enterprises. End summary.

¶12. (SBU) Congenoffs met on January 21, 2009, with Lin Fu, Chairman of the Board, Bank of Nanjing; Sheng Hong, Assistant Executive President, Nanjing Branch, China Everbright Bank; and Leo Lai, General Manager and Head of Business Development, Nanjing Branch, Standard Chartered Bank (please protect). Bank of Nanjing has close relations with the municipal government, which is the bank's single largest shareholder (at 12.9 percent); French bank BNP has 12.6 percent strategic stake. (Note: Lin himself is the former deputy director of the Nanjing Municipal Finance Bureau, and he confirmed Bank of Nanjing continues to hold bureau-level status within the municipal government. End note.) The Everbright Nanjing Branch operates throughout Jiangsu Province, except for Suzhou (where there is a separate Everbright branch), and holds a 5 percent market share of banking activity in Nanjing; it has not yet been able to issue an IPO. Standard Chartered has been in Nanjing for over 15 years, and is the largest foreign bank in Nanjing; given the strong local competition, it focuses on interest rate swaps, currency exchange, and cash management for foreign firms.

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Surge in Loans for Government Projects
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¶13. (SBU) The Nanjing bank representatives confirmed new lending for government-sponsored projects surged in December and January. Everbright's Sheng told Congenoffs that his branch's new lending in the first twenty days of January alone equaled total lending in 2008. (Note: Congenoffs later reconfirmed this statistic with Sheng's staff. End note.) Sheng explained that Everbright by October 2008 had many loans which had been fully vetted and approved, but People's Bank of China (PBOC) lending

restrictions meant that projects were queued up by priority to receive funds. Once the PBOC began encouraging lending in October, Everbright was able to release funds for multiple projects simultaneously. Bank of Nanjing's Lin offered a similar picture, explaining that Bank of Nanjing took a few weeks to review its loan backlog in October and November, and then began a surge of credit issuance in December.

¶14. (SBU) Lin and Sheng agreed that it was the PBOC lending quotas that made the greatest difference in their loan issuance rates. Sheng went as far to say that the PBOC's changes in the required reserve ratio for banks (the amount of deposits required to be kept in reserve and not loaned out) and base loan interest rates made no difference for his bank--"These matter only to our head office in Beijing," he noted. Lin said PBOC loan quotas forced Bank of Nanjing to invest much of its RMB6.7 billion (currently approximately US\$1 billion) 2007 IPO proceeds in Chinese government bonds, leading to it being known as the "Bond Bank." Bank of Nanjing currently has 40 percent of its assets in bonds, said Lin.

¶15. (SBU) Local governments set lending priorities, our contacts indicated. Sheng said Everbright was focused on loans that support Jiangsu's urbanization, provincial industries, local small and medium-size enterprises (SMEs), and consumer credit. He emphasized Everbright's loans to provincial enterprises centered on enhancing their competitiveness in international markets rather than reorienting their production toward China's domestic consumers. Sheng acknowledged the Central Government's effort to increase the economy's reliance on domestic demand, but argued such a transformation was too difficult in the short term. For instance, Everbright, Nanjing, is the largest creditor of the Xugong Group, a manufacturer of heavy construction equipment based in Xuzhou, Jiangsu, and has extended several billion yuan in loans to Jiangsu shipbuilders. Sheng also revealed that much of the new lending in December and January has been channeled through local government investment corporations. Standard Chartered's Lai said he had heard that the Jiangsu authorities are guaranteeing the new loans, but he has not been able to confirm this.

¶16. (SBU) Bank of Nanjing's Lin gave expansion of local universities and highways as examples of his bank's lending to locally supported projects. One university wanted to speed up its three-year expansion project, said Lin, and therefore borrowed funds equivalent to the budget for the project's second and third years from the Bank of Nanjing; Lin said the loan risk is minimal, because the bank can be repaid from the university's allocations from the government over the coming two years.

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Local Government and Regulators Push Lending in October

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¶17. (SBU) Everbright's Sheng offered further details on the Jiangsu Government's efforts to increase lending in the fourth quarter of 2008. The Jiangsu Provincial Government's Financial Affairs Office (jinrong ban) called a meeting in October meeting that was attended by both Jiangsu Governor Liang Baohua and the vice governor in charge of financial affairs. It was the first time in his twenty years in the banking industry to see top officials come together to focus on banking affairs in this way, said Sheng. According to Sheng, Jiangsu will be compared against Zhejiang and Guangdong in terms of loan growth rates, and "None of the provinces wants to be last."

¶18. (SBU) The bank representatives suggested that Nanjing banks' response to local government guidance since October is out of line the trend that bankers are less susceptible to official interference. Nevertheless, Everbright's Sheng said that although he attends all meetings called by local and provincial financial officials, he generally is easily able to deflect their requests by saying that the bank's head office in Beijing does not approve.

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Continuing Caution on SME Lending

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¶9. (SBU) Everbright's Sheng said banks find it difficult to fulfill regulator's instructions for lending to SMEs. (Note: SME lending is a priority under the Central Government's RMB4 trillion fiscal stimulus package announced November 9. End note.) The China Bank Regulatory Commission requires banks to maintain credit growth for SMEs, said Sheng, but there are few opportunities where the return matches the risk. As an example of SME lending Everbright can undertake, Sheng cited loans to Jiangsu car dealers for new car purchases where the vehicles are used as collateral. If the dealer is not able to repay the loan, he said, under the terms of the loan the cars can be resold by the bank to the manufacturer.

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Comment

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¶10. (SBU) Initial signs in Jiangsu Province are that banks and local governments have embraced the opportunity offered by the Chinese Central Government's RMB4 trillion fiscal stimulus package to ramp up investment in infrastructure and enterprises. Less certain are the intentions of local governments to push China away from a focus on investment and exports and towards domestic consumption as a stronger economic driver.

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